

Edgar Filing: NUTRACEA - Form 10QSB

NUTRACEA  
Form 10QSB  
August 16, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE  
EXCHANGE ACT FOR THE TRANSITION PERIOD FROM  
\_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-32565  
-----

NUTRACEA  
-----

(Exact name of small business issuer as specified in its charter)

CALIFORNIA  
-----

87-0673375  
-----

(State of other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification  
Number)

1261 Hawk's Flight Court  
El Dorado Hills, California  
(Address of Principal Executive Offices)  
-----

95762  
(Zip Code)  
-----

Issuer's telephone number: (916) 933-7000  
-----

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  No

The number of shares of the issuer's common stock outstanding as of August 6, 2004 was 26,413,114.

Transitional Small Business Disclosure Format (Check One): Yes \_\_\_\_\_ No  \_\_\_\_\_

INDEX

Page  
-----

# Edgar Filing: NUTRACEA - Form 10QSB

## PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS. . . . .	2
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS. . . . .	12
ITEM 3. CONTROLS AND PROCEDURES . . . . .	14
 PART II - OTHER INFORMATION	
ITEM 2. CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES. . . . .	16
ITEM 5. OTHER INFORMATION. . . . .	16
ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K . . . . .	16

## PART I - FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

#### NUTRACEA INDEX TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Balance Sheet as of June 30, 2004 (Unaudited). . . . .	2
Consolidated Statements of Operations for the three and six months ended June 30, 2004 and 2003 (Unaudited) . . . . .	3
Consolidated Statements of Cash Flows for the six months ended June 30, 2004 and 2003 (Unaudited) . . . . .	4
Notes to Unaudited Consolidated Financial Statements. . . . .	5

#### NUTRACEA AND SUBSIDIARIES Consolidated Balance Sheet June 30, 2004 (Unaudited)

#### ASSETS

CURRENT ASSETS	
Cash	\$ 1,012,744
Accounts receivable-trade	1,671
Inventory, net	178,968
Prepaid expenses	15,541
	-----
Total current assets	1,208,924
EQUIPMENT, net	34,583

Edgar Filing: NUTRACEA - Form 10QSB

PATENTS AND TRADEMARKS, net	306,314
GOODWILL	250,001
	-----
TOTAL ASSETS	\$ 1,799,822
	=====
LIABILITIES AND SHAREHOLDERS' EQUITY	
Accounts payable	\$ 525,661
Accrued expenses	65,312
Due to related parties	5,358
Customer deposits	106,486
Convertible, mandatorily redeemable series A preferred stock, no par value, \$1 stated value, 20,000,000 shares authorized, 430,000 shares issued and outstanding	212,361
	-----
Total current liabilities	915,178
	-----
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY	
Common stock, no par value, 100,000 shares authorized, 26,401,408 shares issued and outstanding	42,475,581
Deferred compensation	(23,932)
Accumulated deficit	(41,567,005)
	-----
Total shareholders' equity	884,644
	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,799,822
	=====

3

NUTRACEA  
AND SUBSIDIARIES  
Consolidated Statements of Operations and Comprehensive Loss  
(unaudited)

	For the Six Months Ended June 30,		For the Three Months Ended June 30,	
	2004	2003	2004	2003
		(Restated)		(Restated)
REVENUES				
Net sales	\$ 413,070	\$ 575,432	\$ 291,001	\$ 349,441
COST OF GOODS SOLD				
	231,425	323,120	152,760	195,721
	-----	-----	-----	-----
GROSS PROFIT	181,645	252,312	138,241	153,720
OPERATING EXPENSES	20,397,884	1,298,356	2,551,425	835,749
	-----	-----	-----	-----
LOSS FROM OPERATIONS	(20,216,239)	(1,046,044)	(2,413,184)	(682,029)
	-----	-----	-----	-----
OTHER INCOME (EXPENSE)				

Edgar Filing: NUTRACEA - Form 10QSB

Interest income	3,057	-	2,119	-
Interest expense	(495)	(39,877)	-	(22,686)
	-----	-----	-----	-----
Total other income (expense)	2,562	(39,877)	2,119	(22,686)
	-----	-----	-----	-----
NET LOSS	(20,213,677)	(1,085,921)	(2,411,065)	(704,715)
CUMULATIVE PREFERRED DIVIDEND	(8,373)	(75,064)	-	(37,532)
	-----	-----	-----	-----
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	\$ (20,222,050)	\$ (1,160,985)	\$ (2,411,065)	\$ (742,247)
	=====	=====	=====	=====
BASIC AND DILUTED LOSS AVAILABLE TO COMMON SHAREHOLDERS PER SHARE	\$ (1.16)	\$ (0.47)	\$ (0.10)	\$ (0.29)
	=====	=====	=====	=====
BASIC AND DILUTED WEIGHTED- AVERAGE SHARES OUTSTANDING	17,465,704	2,470,871	24,616,107	2,522,280
	=====	=====	=====	=====

4

NUTRACEA  
AND SUBSIDIARIES  
Consolidated Statements of Cash Flow  
(unaudited)

	For the six months ended June 30,	
	2004	2003
	-----	-----
		(Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (20,213,677)	\$ (1,085,921)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	13,942	64,100
Amortization of deferred compensation	49,670	44,006
Non-cash issuances of stock options and warrants	7,761,515	398,650
Non-cash issuances of stock as compensation	10,726,984	-
(Increase) decrease in		
Accounts receivable	28,782	(2,808)
Inventory	(108,074)	(56,155)
Prepaid expenses	(684)	22,029
Deposits	-	(103,021)
Accounts payable	279,252	96,480
Due to factor	-	103,066
Accrued salaries and benefits	(15,642)	(17,145)
Deferred compensation	(47,842)	282,869
Accrued expenses	6,459	(10,104)
Customer deposits	5,000	134,816

## Edgar Filing: NUTRACEA - Form 10QSB

Due to related parties	(13,030)	7,355
	(1,527,345)	(121,783)
Net cash used in operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(20,849)	(1,103)
Purchase of patents and trademarks	(44,637)	(5,145)
	(65,486)	(6,248)
Net cash used in investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from convertible notes payable	-	156,700
Principal payments on notes payable	-	(50,000)
Proceeds from notes payable - related parties	-	275,422
Payments on notes payable - related parties	-	(210,000)
Proceeds from issuance of common stock	-	104,500
Proceeds from exercise of stock options	2,767,368	1,000
Common stock repurchase	(230,000)	-
Payment of preferred dividends	(31,816)	-
	2,505,552	277,622
Net cash provided by financing activities		
Net increase in cash	912,721	149,591
CASH, BEGINNING OF PERIOD	100,023	34,718
	\$ 1,012,744	\$ 184,309
CASH, END OF PERIOD	=====	=====

5

NUTRACEA AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1-BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated financial statements of NutraCea have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission ("SEC"), and should be read in conjunction with the audited financial statements and notes thereto contained in NutraCea's Annual Report filed with the SEC on Form 10-KSB. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements that would substantially duplicate the disclosure contained in the audited financial statements for 2003 as reported in the 10-KSB have been omitted.

NOTE 2-RESTATEMENT:

NutraCea has restated its Consolidated Financial Statements for the second quarter of 2003 to correct an error in valuation of stock-based compensation. This restatement increased operating expenses and the net loss attributable to common shareholders by \$373,900 for the quarter and six months ended June 30, 2003.

Edgar Filing: NUTRACEA - Form 10QSB

	For the six months ended June 30, 2003			For the Ju	
	As previously reported	Restatement adjustments	As restated	As previously reported	R a
Operating expenses	\$ 924,456	373,900	\$ 1,298,356	\$ 461,849	
Net loss available to common shareholders	\$ (787,085)	(373,900)	\$ (1,160,985)	\$ (368,347)	
Basic and diluted loss available to common shareholders per share	\$ (0.32)	(0.15)	\$ (0.47)	\$ (0.15)	

The following table presents the effects of the correction and restatement on a condensed basis.

NOTE 3-STOCK-BASED COMPENSATION:

Compensation is recorded for stock-based compensation grants based on the excess of the estimated fair value of the common stock on the measurement date over the exercise price. Additionally, for stock-based compensation grants to consultants, NutraCea recognizes as compensation expense the fair value of such grants as calculated pursuant to SFAS No. 123, recognized over the related service period. SFAS No. 148 requires companies to disclose proforma results of the estimated effect on net income and earnings per share to reflect application of the fair value recognition provision of SFAS No. 123.

6

	For the six months ended June 30,		For the three months ended June 30,	
	2004	2003 (Restated)	2004	2003 (Restated)
Net loss available to common shareholders: As reported:	\$ (20,222,050)	\$ (1,160,985)	\$ (2,411,065)	\$ (742,247)
Less: compensation expense charged to income:	7,761,515	398,650	490,455	398,650
Plus: proforma compensation expense:	(7,761,515)	(491,732)	(490,455)	(491,732)
Proforma net loss available to common shareholders:	\$ (20,222,050)	\$ (1,254,067)	\$ (2,411,065)	\$ (835,329)
Basic loss per common share: As reported:	\$ (1.16)	\$ (0.47)	\$ (0.10)	\$ (0.29)
Proforma:	\$ (1.16)	\$ (0.51)	\$ (0.10)	\$ (0.33)

NOTE 4 - COMMITMENTS AND CONTINGENCIES

Agreements

## Edgar Filing: NUTRACEA - Form 10QSB

-----  
For all agreements where stock is awarded as partial or full consideration, the expense is valued at the fair value of the stock. Expense for stock options and warrants issued to consultants is calculated at fair value using the Black-Scholes valuation method.

Effective January 1, 2004, NutraCea amended two executive employment contracts to reflect quarterly bonuses. Under the contract, compensation shall be \$45,000 per calendar quarter, with 250,000 shares of common stock to be granted in the event NutraCea achieves gross revenues of \$1 million or more for the quarter. In addition, a one-time stock grant of 550,000 shares of common stock will be awarded for the first quarter gross revenues equal or exceed \$5 million. This bonus agreement is effective until April 15, 2006, unless extended by the board. NutraCea also agreed to maintain an annual bonus program for members of the senior management group, including the Chief Executive Officer. The Chief Executive Officer shall be eligible to receive an annual bonus under terms otherwise governing the annual bonus program.

Effective January 1, 2004, NutraCea amended the stock options section of an executive employment contract dated April 15, 2003. The amendment changed the vesting conditions on 250,000 shares of common stock to "upon the completion of the twelfth month of employment " instead of "upon the Company achieving two successful calendar quarters of net profits from operations of the business of the Company before interest, taxes, depreciation and amortization as conclusively determined by the independent certified public accountant for the Company".

On January 12, 2004, NutraCea entered into a one-year consulting agreement with a sales and marketing company. Under the terms of the agreement, compensation shall be warrants to purchase 4,000,000 shares of common stock as follows: 300,000 shares at \$.50 per share on or before January 12, 2004; 400,000 shares at \$.50 per share on or before February 17, 2004; and 3,300,000 shares at \$.50 per share on or before April 19, 2004. Non-cash compensation expense of \$3,911,886 was recorded relating to this agreement. All of the warrants had been exercised at March 31, 2004.

On January 28, 2004, NutraCea entered into a one-year consulting agreement with a sales and marketing company. Under the terms of the agreement, compensation shall be warrants to purchase 90,000 shares of common stock at an exercise price of \$.01 per share. Non-cash

7

compensation expense of \$137,158 was recorded relating to this agreement. As of March 31, 2004, these warrants had been exercised.

On February 2, 2004, NutraCea entered into a six -month consulting agreement with a communications company. Under the terms of the agreement, compensation shall be \$2,500 per month, plus shares of common stock valued at \$6,000 issued at signing of contract. Either party may terminate the agreement with sixty days written notice. At March 31, 2004, the shares had been issued in full.

On February 23, 2004, NutraCea entered into a one-year consulting agreement with a marketing company. Under the terms of the agreement, compensation shall be monthly issuance of shares of common stock valued at \$7,500 per month. In addition, the consultant is entitled to a 3% commission on equity or debt financing introduced to NutraCea.

On March 1, 2004, NutraCea entered into a 90-day consulting agreement with a financial relations company. Compensation shall be the issuance of 100,000

## Edgar Filing: NUTRACEA - Form 10QSB

shares of common stock per month. As of March 31, 2004, 100,000 shares valued at \$142,000 had been issued to the consultant.

On March 1, 2004, NutraCea entered into a one-year consulting agreement with a sales and marketing company. Compensation shall be the issuance of 25,000 shares of common stock. At March 31, 2004, these shares had been issued. Non-cash compensation expense of \$35,500 was recorded relating to this agreement.

On March 9, 2004, NutraCea entered into a one-year consulting agreement with a communications company. Under the terms of the agreement, compensation shall be issuance shares of common stock valued at \$36,000. At March 31, 2004, these shares have been issued in full.

On March 15, 2004, NutraCea entered into a six-month consulting agreement with a sales and marketing company. Under the terms of the agreement, compensation shall be warrants to purchase 400,000 shares of common stock, at an exercise price of \$.001 and warrants to purchase up to 1,000,000 shares of common stock at an exercise price of \$1.20, to be exercised within three years. At March 31, 2004, the 400,000 warrants exercisable at \$.001 had been exercised. Non-cash compensation expense of \$2,149,598 was recorded relating to this agreement.

On March 19, 2004, NutraCea approved granting a one-time cash bonus of 2/3 of normal salary to the CEO and President. The bonus amount for both executives is \$180,000, payable April 1, 2004.

On March 25, 2004, NutraCea entered into two, two-year consulting agreements with two medical advisors. Under the terms of the agreement, compensation shall be 100,000 shares of common stock each, payable in advance, and options to purchase 100,000 shares of common stock at a price of \$.50 per share for the second year of service. The 200,000 shares of common stock are valued at \$286,000, and the options are valued at \$107,684. Expense for these amounts was recorded in April 2004 when the shares and options were issued.

On March 25, 2004, NutraCea entered into a three-year consulting agreement with a development and marketing company. Under the terms of the agreement, compensation shall be \$1 per unit (a minimum 30-day supply of NutraCea product) for up to a total accumulated payment of \$750,000, and \$.50 per unit thereafter, payable quarterly within 45 days after the end of the quarter. In addition, NutraCea will issue 100,000 shares of common stock for each probiotic formulation NutraCea markets, and options to purchase 300,000 shares of common stock at an exercise price of \$1 per share with 100,000 options to be vested immediately and 50,000 shares per year thereafter. The vested options are valued at \$102,782.

8

On April 2, 2004, NutraCea entered into a 180-day consulting agreement with a marketing and investor relations company. The term can be extended another 180 days by mutual agreement. Under the terms of the agreement, compensation shall be 400,000 shares of common stock, and \$4,000 cash per month. Compensation shall also include an 8% cash commission on equity or debt financing introduced to NutraCea, as well as a warrant, exercisable within 3 years, for common shares to equal 10% of the gross financing proceeds. The warrant is to be priced at 110% of the closing bid price for the preceding 30 business days of the day of closing, such warrant or shares to be issued at closing.

On April 29, 2004, NutraCea entered into a one-year consulting agreement (with options to extend for four successive terms of one year each) with two retired employees of NutraCea. Under the terms of the agreements, annual compensation of \$70,000 and \$80,000 each is payable on a monthly basis. In addition, each of



## Edgar Filing: NUTRACEA - Form 10QSB

the consultants received warrants to purchase 50,000 shares of common stock at \$.20 a share. The 100,000 warrants are valued at \$91,370 and expire in 5 years. Either party can cancel this agreement with 30-day written notice.

On April 15, 2004, NutraCea entered into a one-year consulting agreement with a sales and marketing consultant. Under the terms of the agreement, compensation shall be warrants to purchase 50,000 shares of common stock at \$.80 per share upon the completion of certain benchmarks. The warrants are valued at \$46,758 and expire in 3 years.

On June 2, 2004, NutraCea entered into two consulting agreements with sales and marketing consultants. Under the terms of the agreements, each consultant shall be issued 150,000 restricted shares of common stock, valued at \$161,500. The agreement calls for these shares to be included in the next registration statement filed.

### NOTE 5 - COMMON STOCK

#### Common and Preferred Stock

-----

All stock issued is valued at the fair value of the stock.

On March 25, 2004, NutraCea established the NutraCea Patent Incentive Plan, which grants 15,000 shares of common stock to each named inventor on each granted patent which is assigned to NutraCea.

During the quarter ended March 31, 2004, NutraCea issued 544,965 shares of common stock to consultants for services rendered valued at \$723,381.

During the quarter ended March 31, 2004, NutraCea issued 168,095 shares of common stock to vendors in payment of accounts payable totaling \$57,111.

During the quarter ended March 31, 2004, NutraCea issued 6,490,711 shares of common stock pursuant to the exercise of stock options and warrants for cash totaling \$2,744,507.

During the quarter ended March 31, 2004, NutraCea issued 280,000 shares of common stock to two consultants in settlement of contractual agreements valued at \$477,816.

During the quarter ended March 31, 2004, NutraCea issued 5,500,000 shares of common stock, valued at \$8,360,000, to NutraCea's Chief Executive Officer for current services rendered. 175,000 of these shares replace shares owned by NutraCea's CEO and used to satisfy NutraCea obligations and the balance of the shares will be held in escrow to satisfy a deferred compensation arrangement between NutraCea and the CEO.

On April 1, 2004, NutraCea repurchased 344,956 shares of common stock valued at \$230,000 from the Chief Executive Officer of NutraCea pursuant to a repurchase agreement of that date.

9

During the quarter ended June 30, 2004, NutraCea issued 1,083,489 shares of common stock to consultants for services rendered valued at \$1,380,287.

During the quarter ended June 30, 2004, NutraCea issued 531 shares of common stock to a vendor in payment of accounts payable in the amount of \$833.

During the quarter ended June 30, 2004, NutraCea issued 438,612 shares of common

## Edgar Filing: NUTRACEA - Form 10QSB

stock pursuant to the exercise of stock options and warrants for cash totaling \$22,861.

During the quarter ended June 30, 2004, NutraCea converted 510,000 shares of preferred stock to 510,000 shares of common stock pursuant to the Mandatory Conversion paragraph of the Private Placement Memorandum dated November 9, 2001.

During the quarter ended June 30, 2004, NutraCea converted preferred dividends in the amount of \$5,986 into 5,759 shares of common stock.

### Stock Options & Warrants

-----

Expense for stock options and warrants issued to consultants is calculated at fair value using the Black-Scholes valuation method.

During the quarter ended March 31, 2004, NutraCea issued 6,547,263 warrants with exercise prices between \$.001 and \$5.00 per share to consultants. The warrants expire at varying times between six months and five years. A total of \$7,271,060 in non-cash compensation expense was recorded relating to the issue of these warrants.

During the quarter ended June 30, 2004 NutraCea issued 451,230 warrants with exercise prices between \$.001 and \$5.00 to consultants. The warrants expire at varying times between three and five years. A total of \$490,455 in non-cash compensation expense was recorded relating to the issue of these warrants.

10

### NOTE 6 - BUSINESS SEGMENTS

For internal reporting purposes, management segregates NutraCea into operating segments as follows for the six and three months ended June 30, 2004 and 2003:

SIX MONTHS ENDED JUNE 30, 2004	NET SALES	(LOSS) FROM OPERATIONS	INTEREST EXPENSE	TOTAL ASSETS	DEPRE AMOR
-----					
NutraStar Technologies Incorporated	\$ 217,197	\$ (4,070)	\$ 495	\$ 1,781,789	\$
NutraGlo Incorporated	195,873	60,109	-	18,033	-
Unallocated corporate overhead	-	(20,272,278)	-	-	-
<b>Total, NutraCea</b>	<b>\$ 413,070</b>	<b>\$ (20,216,239)</b>	<b>\$ 495</b>	<b>\$ 1,799,822</b>	<b>\$</b>
=====					
SIX MONTHS ENDED 6/30/2003 (RESTATED)	NET SALES	(LOSS) FROM OPERATIONS	INTEREST EXPENSE	TOTAL ASSETS	DEPRE AMOR
-----					
NutraStar Technologies Incorporated	\$ 63,073	\$ 106,404	\$ 39,877	\$ 625,991	\$
NutraGlo Incorporated	512,359	183,714	-	133,263	-
Unallocated corporate overhead	-	(1,336,162)	-	-	-
<b>Total, NutraCea</b>	<b>\$ 575,432</b>	<b>\$ (1,046,044)</b>	<b>\$ 39,877</b>	<b>\$ 759,254</b>	<b>\$</b>
=====					
THREE MONTHS ENDED JUNE 30, 2004	NET SALES	(LOSS) FROM OPERATIONS	INTEREST EXPENSE	TOTAL ASSETS	DEPRE AMOR
-----					

## Edgar Filing: NUTRACEA - Form 10QSB

NutraStar Technologies Incorporated	\$ 95,234	\$ 92,473	\$ -	\$ 1,781,789	\$
NutraGlo Incorporated	195,767	(25,740)	-	18,033	
Unallocated corporate overhead	-	(2,479,917)	-	-	
<hr style="border-top: 1px dashed black;"/>					
Total, NutraCea	\$ 291,001	\$ (2,413,184)	\$ -	\$ 1,799,822	\$
<hr style="border-top: 3px double black;"/>					

THREE MONTHS ENDED 6/30/2003 (RESTATED)	NET SALES	(LOSS) FROM OPERATIONS	INTEREST EXPENSE	TOTAL ASSETS	DEPRE AMOR
<hr style="border-top: 1px dashed black;"/>					
NutraStar Technologies Incorporated	\$ 38,323	\$ 85,602	\$ 22,686	\$ 625,991	\$
NutraGlo Incorporated	311,118	102,470	-	133,263	
Unallocated corporate overhead	-	(870,101)	-	-	
<hr style="border-top: 1px dashed black;"/>					
Total, NutraCea	\$ 349,441	\$ (682,029)	\$ 22,686	\$ 759,254	\$
<hr style="border-top: 3px double black;"/>					

### NOTE 7 - SUBSEQUENT EVENTS

#### Common and Preferred Stock

All stock issued is valued at the fair value of the stock.

On July 1, 2004, NutraCea issued 12,066 shares of common stock to consultants for services rendered valued at \$12,500.

On July 9, 2004, the holder of a Put/Call Agreement dated January 15, 2002 notified NutraCea of its intent to exercise its Put Right for 130,000 preferred shares to NutraCea for purchase at \$1.00 per share, or \$130,000, plus all accumulated but unpaid dividends.

#### Stock Options & Warrants

Expense for stock options and warrants issued to consultants is calculated at fair value using the Black-Scholes valuation method.

On July 9, 2004, NutraCea issued 25,000 stock options with an exercise price of \$.20, expiring in five years, to an employee of the Company. Non-cash compensation expense of \$21,000 was recorded relating to the issue of these options.

11

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

#### CAUTION ABOUT FORWARD-LOOKING STATEMENTS

This Form 10-QSB includes "forward-looking" statements about future financial results, future business changes and other events that have not yet occurred. For example, statements like NutraCea "expects," "anticipates" or "believes" are forward-looking statements. Investors should be aware that actual results may differ materially from NutraCea's expressed expectations because of risks and uncertainties about the future. NutraCea does not undertake to update the information in this Form 10-QSB if any forward-looking statement later turns out to be inaccurate. Details about risks affecting various aspects of NutraCea's business are discussed throughout this Form 10-QSB and should be considered carefully.

## Edgar Filing: NUTRACEA - Form 10QSB

### RESULTS OF OPERATIONS

Revenues of NutraCea decreased by \$162,362, to \$413,070 for the six months ended June 30, 2004 from \$575,432 for the six months ended June 30, 2003. Revenues also decreased by \$58,440, to \$291,001 for the quarter ended June 30, 2004 from \$349,441 for the quarter ended June 30, 2003. The decreases are primarily due to decreased purchases by the major customer of the Company's subsidiary NutraGlo Incorporated.

Cost of goods sold decreased by \$91,695, to \$231,425 for the six months ended June 30, 2004 from \$323,120 for the six months ended June 30, 2003. Cost of goods sold also decreased by \$42,961, to \$152,760 for the quarter ended June 30, 2004 from \$195,721 for the quarter ended June 30, 2003. The decrease relates directly to the decrease in sales.

Operating expenses increased by \$19,099,528, to \$20,397,884 for the six months ended June 30, 2004 from \$1,298,356 for the six months ended June 30, 2003. Operating expenses also increased by \$1,715,676, to \$2,551,425 for the quarter ended June 30, 2004 from \$835,749 for the quarter ended June 30, 2003. Non-cash stock and option awards increased by \$18,368,279, to \$18,776,929 for the six months ended June 30, 2004 from \$398,650 for the six months ended June 30, 2003, and by \$1,478,911, to \$1,877,561 for the quarter ended June 30, 2004 from \$398,650 for the quarter ended June 30, 2003. We are continuing in 2004 to conserve our positive cash position by issuing options and stock for services whenever possible. Other significant operating expense increases are as follows:

	For the six months ended June 30, 2004	For the quarter ended June 30, 2004
	-----	-----
Commissions and finders fees	\$ 209,438	\$ 39,000
Professional fees	174,130	119,400
Promotional and marketing	77,375	32,165
Travel	63,027	48,145
	-----	-----
	\$ 523,970	\$ 238,710
	=====	=====

In addition, salaries and wages increased during the six months ended June 30, 2004 by approximately \$130,000 due to one-time cash bonuses to the Company's CEO and President.

Interest expense decreased by \$39,382, to \$495 for the six months ended June 30, 2004 from \$39,877 for the six months ended June 30, 2003. Interest expense also decreased by \$22,686, to

zero interest expense for the quarter ended June 30, 2004 from \$22,686 for the quarter ended June 30, 2003. The decrease is due to the elimination of interest expense on notes that were paid off in 2003.

The Company posted an operating loss of \$2,413,184 for the quarter ended June

## Edgar Filing: NUTRACEA - Form 10QSB

30, 2004 compared to an operating loss of \$682,029 for the same quarter in 2003. The operating losses are due to the significant operating expenses consisting primarily of non-cash stock option and warrant awards made to certain officers and consultants of NutraCea. The Company recorded operating losses of \$20,216,239 for the six month period ended June 30, 2004 compared to \$1,046,044 for the first half of 2003. The six month operating loss in 2004 was due primarily to the significant operating expenses incurred in the first quarter of 2004 relating to the issuance of the Company's common stock as compensation and pursuant to the exercise of outstanding options and warrants.

During the quarter ended June 30, 2004 the Company entered into the following consulting agreements:

On April 2, 2004, NutraCea entered into a 180-day consulting agreement with Chamberlain Capital Partners LLC, a marketing and investor relations company, for the purpose of developing a new corporate web site.

On April 29, 2004, NutraCea entered into a one-year consulting agreement (with options to extend for four successive terms of one year each) with Dr. Cherukuri and Dr. Cheruvanky, two retired employees of NutraCea, for the purpose of continuing patent development work and product quality control.

On June 2, 2004, NutraCea entered into one-year consulting agreements with Craig Horn and Carl Kruse for the purpose of identifying and evaluating various stock analysts to assist the Company with investor communications.

On June 7, 2004, NutraCea entered into a three-year consulting agreement with Nussentials, LLC to develop and manage a market for NutraCea products specifically in the direct consumer arena.

### Off-Balance Sheet Arrangements

During the quarter ended June 30, 2004, the Company did not engage in any off-balance sheet arrangements as defined in Item 303 (c) of the SEC's Regulation S-B.

### LIQUIDITY AND SOURCES OF CAPITAL

NutraCea has incurred significant operating losses since its inception, and, as of June 30, 2004 NutraCea had an accumulated deficit of \$41,567,005. However, at June 30, 2004, NutraCea had cash and cash equivalents of \$1,012,744 and working capital of \$293,746.

To date, NutraCea has funded its operations, in addition to sales revenues, through a combination of short-term debt and the issuance of common and preferred stock. During the six months ended June 30, 2004, NutraCea has issued a total of 14,627,566 shares of common stock of which approximately 7.6 million shares were issued as compensation to officers and consultants of the Company. During the six months ended June 30, 2004, NutraCea raised a total of \$2,767,368 from the exercise of options and warrants to purchase 6,929,323 shares of common stock. NutraCea continues to pursue cost cutting or expense deferral strategies in order to conserve working capital.

Based on management's financial projections, NutraCea has enough cash reserves to finance its business plan through fiscal year 2004

Due to the Company's limited cash flow and operating losses, it is unlikely that

## Edgar Filing: NUTRACEA - Form 10QSB

the Company could obtain financing through commercial or banking sources. Consequently, the Company is dependent on continuous cash infusions from major investors and the exercise of outstanding warrants and options in order to fund its current operations. If these sources of capital were unwilling or unable to provide additional working capital to the Company, the Company would probably not be able to sustain its full range of operations. There is no written agreement or contractual obligation which would require the Company's past funding sources to fund the Company's future operations up to certain amounts or indeed continue to finance the Company's operations at all.

As of June 30, 2004, NutraCea's principal commitments include a lease commitment that expires in 2006 of \$ 5,358 per month for the Company's corporate offices.

Management of NutraCea believes that it will need to raise additional capital to continue to develop, promote and conduct its operations. Such additional capital may be raised through public or private financing as well as borrowing from other sources. Although the Company believes that current and/or future investors will continue to fund the Company's expenses, there is no assurance that such investors will continue to fund the Company's ongoing operations or the terms upon which such investments will be made.

### CRITICAL ACCOUNTING POLICIES

NutraCea's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements require managers to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and disclosures on the date of the financial statements. On an on-going basis, the Company's accountants' evaluate the estimates, including, but not limited to, those related to revenue recognition. The Company uses authoritative pronouncements, historical experience and other assumptions as the basis for making judgments. Actual results could differ from those estimates.

The Company has adopted the fair value based method of accounting prescribed in Financial Accounting Standards Board ("FASB") Statement No. 123, "Accounting for Stock-Based Compensation," for its employee stock option plans.

The Company has adopted SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections" which requires gains and losses from extinguishment of debt to be reported as part of recurring operations.

### ITEM 3. CONTROLS AND PROCEDURES

NutraCea has adopted and implemented internal disclosure controls and procedures designed to provide reasonable assurance that all reportable information will be recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms. Under the supervision and with the participation of NutraCea's management, including NutraCea's President and Chief Executive Officer and NutraCea's Controller and Principal Financial Officer, NutraCea has evaluated the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) as of the end of the fiscal quarter covered by this report. Based on that evaluation, the President and Chief Executive Officer and the Controller and Principal Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in NutraCea's internal controls or in other factors during or since the end of the fiscal quarter covered by this report that have had a material effect or are reasonably likely to have a material effect on internal controls subsequent to the end of the fiscal quarter covered by this report.

PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER  
PURCHASES OF EQUITY SECURITIES

Sales of Unregistered Securities During the Quarter

During the quarter ended June 30, 2004, NutraCea issued 701,068 shares of restricted common stock to consultants for services rendered valued at \$840,600.

During the quarter ended June 30, 2004, NutraCea issued 340,000 shares of restricted common stock to officers and directors for services rendered valued at \$498,800.

During the second quarter, the Company issued a warrant to one consultant to purchase common stock equal to 10% of any financing proceeds arranged by the consultant.

During the second quarter, the Company issued options and warrants to purchase 451,230 shares of the Company's common stock. Such warrants were valued at \$490,455.

During the quarter ended June 30, 2004, NutraCea issued 531 shares of common stock to a vendor in payment of accounts payable in the amount of \$833.

During the quarter ended June 30, 2004, NutraCea issued 188,612 shares of common stock pursuant to the exercise of stock options and warrants for cash totaling \$22,611.

All of the above issuances were made without any public solicitation, to a limited number of investors or related individuals or entities and were acquired for investment purposes only. Each of the individuals or entities had access to information about NutraCea and was deemed capable of protecting their own interests. The securities were issued pursuant to the private placement exemption provided by Section 4(2) of the Securities Act of 1933 ("1933 Act"). These are deemed to be "restricted securities" as defined in Rule 144 under the 1933 Act and bear a legend stating the restrictions on resale.

ITEM 5. OTHER INFORMATION

On February 23 and March 19, 2004, respectively, Eliot Drell, MD and Ernie Bodai, MD were appointed to serve on the Board of Directors until the next annual shareholders meeting and Board election.

Subsequent to the quarter ended June 30, 2004, John Howell resigned as President and as a director of NutraCea.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following documents are filed as exhibits to this report:

- 31.1 Certification by CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification by CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification by CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: NUTRACEA - Form 10QSB

(b) Reports on Form 8-K: None

15

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NUTRACEA

Dated: August 16, 2004

/s/Patricia McPeak

-----  
Patricia McPeak  
Chief Executive Officer

Dated: August 16, 2004

/s/ Joanna Hoover

-----  
Joanna Hoover,  
Chief Financial Officer  
(Principal Accounting Officer)

16